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TAGS: ETRD PGOV PREL DR
SUBJECT: DOMINICAN POLITICS #21: PROSPECTS FOR CAFTA
RATIFICATION

¶1. (SBU) Following is # 21 in our series on the politics of Leonel Fernandez's first year:

Summary. The various players in the decision process for the CAFTA regional free trade agreement all know that ratification is necessary as soon as the U. S. Congress approves implementing legislation. Positions have hardened, with major business associations demanding an end to taxation and levies totaling 32 percent on imports of capital goods and industrial inputs. Policymakers must reconcile the requirements of the IMF agreement, the CAFTA agreement, and the business elites -- it's no surprise that many Dominicans are yearning for more time. End Summary.

The Dominican Republic signed the CAFTA free trade agreement last August 5 along with all other parties, in the last ten days of the administration of Hipolito Mejia. Incoming President Leonel Fernandez has all along spoken of the need to meet the pressures of globalization and competition; he has regularly endorsed CAFTA as the way of doing so. However, as powerful sugar interests lobbied, propagandized, induced Congress to pass a deal-killing protectionist tax, and enlisted Fernandez himself to write to President Bush via Governor Jeb Bush of Florida, Fernandez has avoided pressing the opposition-dominated Congress for action. The repeal of the protectionist tax in December became possible when Fernandez's senior advisors made promises -- not divulged and perhaps not specific -- to provide compensatory measures to losing sectors. The administration had a stronger hand at that time because the IMF had set congressional passage of a 2005 budget as a precondition for submitting the standby to the IMF board.

The Dominican Senate has moved with all due deliberate speed since that time. Chair of the special committee Sen. Alejandro Santos held two major open hearings, then traveled to Washington with two colleagues to make the rounds of Congressional representatives, officials and interest groups there. On April 6 he invited sector representatives for yet another round of talks, this time in the semi-private setting of the Hotel Santo Domingo. Embassy political officer attended the discussion, which brought no surprises except for Santos' declaration that he expected the Senate to approve the agreement by the end of the month and send it to the House of Representatives. He and Senate President Andres Bautista said the Senate should ratify CAFTA &as rapidly as possible8 but first should approve measures &to mitigate the possible negative effects.8 They said those measures should be compatible with CAFTA and the IMF agreement, should be economically rational, and should put the country on an equal basis with its Central American competitors. Foreign Minister Carlos Morales Tronocoso told Washington officials on April 11 that he expected ratification in the month of May and that the concerns of the sugar sector were being dealt with satisfactorily.

THE EXCHANGE COMMISSION

Industrialists say that as a pre-condition for assenting to CAFTA ratification, they want the government to abolish the 13 percent "exchange commission" collected on the CIF value of all imports -- or at a minimum, to end it for the imports of capital investment goods and inputs for manufacturing. They have regularly published a chart comparing the taxation of such imports in the various CAFTA countries, showing that none of the Centrals collects more than a token amount on such imports. President of the Industrialists Association Yandra Portella asserted that ending the measure would lower government collections by 2.4 billion Dominican pesos (USD 86.4 million).

The "exchange commission" is a revenue subterfuge used earlier and then progressively increased by the Mejia and Fernandez administrations in an effort to meet revenue targets for the IMF standby agreements. The Monetary Board, directors of the Central Bank, imposed the measure, not the

Congress. The Board raised the measure from 10 percent to 13 percent on January 1, to make up for the expiration of a congressionally approved temporary import surcharge. At the request of Honduras, the WTO Dispute Resolution Body considered the measure in 2003 (back when it was only 4.75 percent) and eventually found it counter to WTO commitments. Embassy understands that the requirement of the IMF agreement for the government to propose a "major tax reform" in mid-2005 pushes the government to consider what other revenue measures could offset loss of these revenues.

Finance Minister Bengoa expostulated at the Ambassador's dinner for Chilean trade expert Osvaldo Rosales last week that the mistake of both administrations had been to task Customs to collect the levy; after all, he argued, it was really a tax mostly on offshore transactions. Leading merchant and industrialist "Pepin" Corripio dismissed that logic: "It's a ransom. If you weren't holding the goods hostage in customs, you couldn't collect half of it. "

VAT AND DUTIES ON GOODS FOR INDUSTRY

The other big number for the Dominican exporters in the comparative chart is the value-added tax, or ITBIS, which rose to 16 percent last September. According to the chart, none of the other Latin American CAFTA partners charges a VAT on imports for industry. Portella did not estimate the revenue cost, but her methodology for &exchange commission8 suggests to us that it would be about 3 billion pesos (USD 107 million). The Dominican Republic assesses a 3 percent tariff on imported machinery; none of the Centrals except Costa Rica charges such a tariff, and there it is only 1 percent. Portella estimated that the revenue effect of ending the tariff would be 379 million Dominican pesos (USD 13.5 million).

This fiscal debate revolves really around the issue of timing, with a sub-theme of the political difficulty of planning and negotiating major tax reform involving offsets of more than USD 200 million previously collected on imports of roughly USD 4.5 billion. This compares with a central government budget of 1.6 billion (USD 5.3 billion at the current exchange rate; USD 4.32 billion when drawn up with an assumption of 37 pesos to the dollar). The provisions of CAFTA are designed to deliver the changes that the industrialists have set as their preconditions. Explicit in the CAFTA is the ending of taxes and duties on trade, at least for merchandise imported from member countries.

WHY SUCH HASTE?

With these lines drawn and Leonel Fernandez conspicuously mute about them, a major comment from several business leaders -- especially those close to sugar, such as Luis Viyella of the fertilizer manufacturer FERSAN - - has been that there is "really no hurry to ratify." This issue was raised repeatedly during the successful high-profile working visit of Chilean former trade negotiator Osvaldo Rosales, an initiative of the Ambassador supported by USAID (reftel). Rosales countered the objection with a comic question (&If an attractive international film star like Sharon Stone insisted on a date with you, would you ask her to wait a couple of months while you got yourself into shape?8) and with a reminder: &Timing of ratification is one thing; timing of international investment decisions is another, and those who are full participants from the start will be the most competitive. Those who delay will be left out.8

The CAFTA agreement goes into effect when the United States and one other signatory have ratified. Since three other parties have already done so, the agreement will be &live8 as soon as the U.S. Congress approves implementing legislation. All of the calendars for market opening will begin to run. The remaining signatories will have up to two years to ratify ) failing which, they lose the opportunity and they lose various benefits under U.S. programs favoring Caribbean trade.

The Dominican administration and congressional leadership will have to use political chips to get CAFTA ratified. All are watching the U.S. Congress. Many are hoping that CAFTA will fail to pass there, so that Dominicans will not have to take these difficult decisions. The Dominican tableau is likely to remain static for some time, with the Senate making haste slowly and the business sectors looking to deal with an immobile Fernandez administration. At the same time the Ambassador and Embassy officers will insist with vigor and great optimism that the Dominican administration, Congress, and private sector should seize the salutary opportunity to embrace globalization and market competition.

¶2. (U) Drafted by Michael Meigs, Joseph Goodwin, and Bain Cowell.

¶3. (U) This piece and others in our series may be viewed at our SIPRNET site www.state.sgov.gov/p/wha/santodomingo along

with extensive other material.
HERTELL